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FISCAL IMPACT STATEMENT

LS 6289
BILL NUMBER: SB 216

NOTE PREPARED: Dec 27, 2011
BILL AMENDED:

SUBJECT: Taxation of Civil Service Annuities.

FIRST AUTHOR: Sen. Skinner
FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: <u>X</u> **GENERAL**
DEDICATED
FEDERAL

IMPACT: State & Local

<u>**Summary of Legislation:**</u> The bill provides a 100% income tax deduction, beginning in 2017, for federal civil service annuity income received by an individual or the individual's surviving spouse after subtracting Social Security benefits and railroad retirement benefits. It phases in the deduction from 2013 through 2016. It removes the requirement that an individual must be at least 62 years of age to be eligible for the federal civil service annuity income tax deduction. It also provides that an individual's surviving spouse may be eligible for the federal civil service annuity income tax deduction.

<u>**Effective Date:**</u> July 1, 2012.

<u>**Explanation of State Expenditures:**</u> *Department of State Revenue (DOR)* - The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to reflect the phase-in of the 100% income tax deduction for civil service annuities. The DOR's current level of resources should be sufficient to implement the change.

<u>**Explanation of State Revenues:**</u> <u>*Summary*</u> - The bill phases in a 100% income tax deduction for federal civil service annuity income over five years replacing the current deduction of up to $2,000 of civil service annuity income. The phase-in of the 100% deduction begins in tax year 2013. The additional revenue loss due to the increased deduction is summarized in the table below.

Tax Year	Fiscal Year	Deduction Amount	Annual Revenue Loss
2013	2014	Greater of 20% of the annuity payment or $12,000	$13.4 M
2014	2015	Greater of 40% of the annuity payment or $12,000	$13.4 M
2015	2016	Greater of 60% of the annuity payment or $12,000	$19.1 M
2016	2017	Greater of 80% of the annuity payment or $12,000	$25.5 M
2017 and after	2018 and after	100% of the annuity payment	$32.8 M

As with the current deduction, the phased in and 100% deduction would apply to civil service annuity income received by a retired federal employee or his or her surviving spouse. Also, as is required under the current deduction, annuity income would have to be offset by Social Security and railroad retirement benefits received by the federal retiree for purposes of computing the deduction. From 2013 to 2016, the deduction would equal the greater of a percentage (20%, 40%, 60%, and 80%, respectively) of the annuity minus Social Security and railroad retirement benefits or $12,000. Beginning in 2017, the deduction would be equal to 100% of the annuity minus Social Security and railroad retirement benefits. Revenue from the individual adjusted gross income (AGI) tax is distributed to the state General Fund.

The deduction estimates are based on annuitant and surviving spouse counts, annual annuity payment amounts, and annual COLA percentages supplied by the federal Office of Personnel Management. The revenue loss could be lower than estimated to the extent that Social Security or railroad retirement benefits offset more of the civil service annuity income.

Background Information - Under current statute, taxpayers may deduct up to $2,000 in civil service annuity income. The deduction is equal to the difference between $2,000 and the total amount of Social Security and railroad retirement benefits received by the taxpayer. In 2009, 4,237 taxpayers deducted approximately $7.3 M in civil service annuity income from taxable AGI. The revenue loss from the deduction was approximately $248,000. The deduction has declined by an average of about 0.1% annually since 2004. According to the U.S. Office of Personnel Management, about 26,000 federal retirees and about 8,000 surviving spouses of federal retirees resided in Indiana in 2010. The annuity payments to these individuals totaled about $825.6 M, with an average annuity of about $27,500 for retirees and $15,000 for surviving spouses. The total annuity payments to retirees and surviving spouses in Indiana has increased by an average of about 2.8% from 2006 to 2010.

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the deduction increase will decrease taxable income, counties imposing local option income taxes could potentially experience a decrease in revenue from these taxes. Based on the current average LOIT rate of about 1.4%, the additional revenue loss due to the increased deduction is summarized in the table below.

Tax Year	Fiscal Year	Annual Revenue Loss
2013	2014	$5.6 M
2014	2015	$5.6 M
2015	2016	$7.8 M
2016	2017	$10.3 M
2017 and after	2018 and after	$13.2 M

State Agencies Affected: DOR.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: OFMA Income Tax Databases, 1996-2009; Lynn Wehner, U.S. Office of Personnel Management.

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